

Lessons From an Ideal-typical Case
of Interdependent Policy Making:
Tax Competition in Switzerland

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Part I

Synopsis

Abstract

This synopsis presents the arguments and findings of this thesis and discusses its ambition, contributions, and implications. Two articles of the cumulative dissertation investigate tax competition among Swiss cantons, and the third analyzes the politics of tax centralization in the European Union (EU). While the Swiss analysis substantially contributes to the theoretical and methodological challenges of the research on interdependent policy making, the implications of the EU article are of relevance for understanding the current institutional challenges of the EU. All three articles have been published in international peer-reviewed journals (see Part II of the dissertation for the biographical information on the articles).

1 Summary

As the world becomes ever more integrated, political scientists have over the last few years gone beyond the standard comparative approach, which explains policy change in countries with internal factors and typically assumes that policy decisions in one unit are independent from the decisions of other units. The shift in political science toward the analysis of interdependence follows the work of students of American federalism and international relations, which have studied the diffusion of best practices in federal systems and the international spread of political phenomena. In contrast to comparativists, scholars of the mentioned sub-fields have investigated the phenomenon that policy makers are influenced by decisions of other units, instead of treating interdependence as a theoretical and methodological nuisance (see, e.g., Walker, 1969; Li and Thompson, 1975).

However, the earlier diffusion literature did not have a substantial impact beyond sub-fields, as it concentrated on the rather narrow outcome-oriented idea that policies spread. This has dramatically changed since recent theoretical and methodological advances have shifted the focus of the literature to the more process-oriented study of the mechanisms of interdependent policy making. A vibrantly growing literature, populating and connecting various sub-fields of political science, nowadays analyzes why and how policy makers react to the decisions of other units. The most important ambition of this dissertation is to contribute to that turn in the literature by studying tax competition, a quintessential case of interdependence. Specifically, I analyze tax competition for high income earners among Swiss cantons, which provides, as I will argue, an ideal-typical empirical setting for investigating the nuances of interdependent policy making.

The first part of this synopsis presents the cutting edge of the research on interdependence and explains why I believe that the case of tax competition in Switzerland has great potential for contributing to that literature. I will also discuss how the three articles of the cumulative dissertation speak to one another. However, I would like to highlight that the articles are independent research studies with distinct research questions. Although, in some respects, the contribution of the whole thesis is greater than the sum of its parts, it is important to note that each of the three articles presents an original theoretical and empirical analysis. Let me briefly summarize the arguments and findings of the two Swiss studies:

Article #1 (Wasserfallen, 2014a): The article on contextual variation in interdependent policy making argues that cantons situated close to big centers react more strongly to tax decisions of competitors because they benefit from the public good provision of nearby centers. The empirical findings support the argument that contextual (in this case geographic) variation drives interdependence. The main contributions of the study are the emphasis on the context conditionality of interdependence and the introduction of advanced hierarchical methods for modeling contextual conditionality.

Article #2 (Gilardi and Wasserfallen, 2014): The second Swiss tax competition article hypothesizes that cantonal finance ministers create and enforce norms on appropriate competitive behavior through socialization in regional conferences, which attenuates the extent to which cantons compete with one another. The empirical findings show that cantons indeed compete less strongly with competitors that are organized in the same intergovernmental organization.

The Swiss analysis, which investigates how cantonal policy makers react to tax decisions of other cantons, makes substantial theoretical and methodological contributions to the literature on interdependent policy making by elaborating theoretical arguments on the mechanisms of interdependence and by proposing advanced empirical modeling strategies. The theoretical and methodological contributions will be discussed in this synopsis in more detail, as well as the normative and policy implications of the findings.

Normatively, the findings of the Swiss analysis nuance the one-sided positive assessment of interdependence that some students of American federalism have put forward. Many influential studies have argued that federal systems are superior because policy makers of sub-national units introduce policies that have shown to be successful in other units (Walker, 1969; Gray, 1973; Volden, 2006). While this is a possible outcome of interdependent policy making in federal states, the comprehensive Swiss analysis shows that interdependence can also be politically motivated, instead of representing a rational welfare-maximizing learning process. Furthermore, the thesis contributes to the debate on the argument that politicians' room to maneuver is narrow if they face competitive pressure within a highly integrated setting. In the case of tax competition, some economists have argued that the mobility of tax sources will cause a race-to-the-bottom in tax rates (Zodrow and Mieszkowski, 1986). The findings of the socialization

article, however, highlight that institutions attenuate tax competition dynamics, which is in line with recent research of political scientists showing that political and institutional factors constrain competitive interdependence (Basinger and Hallerberg, 2004; Plümper, Troeger and Winner, 2009).

The third article of this cumulative dissertation uses insights of the Swiss analysis for the investigation of EU tax politics. While the two Swiss articles contribute to the cutting edge research on interdependent policy making, the EU article engages with a core question of integration—namely whether and, if so, the extent to which political integration should complement the deep economic integration. According to the analysis, economic integration, which is typically characterized by transfers of supposedly technical tasks to supranational authorities, increasingly constrains national governance capacities. The basic political dilemma of integration is that this contraction of the domestic political room to maneuver is, by and large, not compensated with shifts of political authorities to the European level. Within that broader context, the third article of this thesis focuses on EU tax centralization.

Article #3 (Wasserfallen, 2014b): The EU study investigates analytically and empirically the negotiations of tax centralization proposals in intergovernmental conferences. The main finding of the article is that low-tax countries were more likely to oppose European tax intervention and that the increased heterogeneity after the enlargements further reduced the already low prospects of tax centralization.

The EU analysis contributes to the understanding of the current institutional challenges and provides distinct policy recommendations. Based on the premise that political authority shifts to the European level, including the transfer of taxation powers, should complement the deep economic integration, the main policy recommendation of the study is to restrict future tax centralization proposals to the eurozone area, mainly because the benefits of shifting financial competences has become greater for the eurozone countries, which form a deeply integrated core group in the EU.

The remainder of the synopsis is structured as follows: Section 2 introduces the literature and the ambition of the thesis; sections 3 and 4 discuss the contribution of the dissertation; sections 5 and 6 present the findings as well as the normative and policy implications of the analysis; and section 7 concludes.

2 Ambition of the Thesis

In the summer of 2008, I applied for the position as a PhD candidate at Prof. Gilardi's chair because I was interested in his internationally renown work on policy diffusion. After the recruitment, it was clear to me that I wanted to write a dissertation that takes advantage of the striking progress that the vastly growing policy diffusion research has made in just a few years. My main ambition was to make a contribution to the theoretical and methodological challenges of that literature. To get started, I first had to study the state-of-the-art of the literature, which I did in conjunction with assisting the teaching of a graduate research seminar on policy diffusion. The teaching of the seminar was a very effective way for me to get familiar with the various facets of the diffusion literature—and, equally important, the complementarity between elaborating my own PhD research design and supporting MA students with their work on diffusion made me experience the unity of research and teaching.

Apart from studying the literature, I had to choose an interesting empirical setting for my thesis. At the very first meeting we had, Prof. Gilardi suggested that tax competition in Switzerland would be a promising empirical setting for making a contribution to the diffusion literature. I think that was an excellent advice, for which I am grateful. In the following, I discuss the cutting edge of the diffusion literature, the ambitions of my thesis, the rationale for choosing tax competition in Switzerland as the empirical setting, and how the third part of my thesis, which analyzes the politics of tax centralization in the EU, is inspired by parts of the research on Swiss tax competition.

2.1 State-of-the-art: From Diffusion to Interdependence

The conventional approach in comparative research is to model policy choices as a function of internal conditions, neglecting that political decisions in one country are not necessarily independent from decisions made in other countries. Contrasting that classical comparative perspective, students of American federalism have studied the argument that states react to one another in policy making by paying particular attention to the notion that states are “policy laboratories” spreading best practices (Walker, 1969; Gray, 1973; Berry and Berry, 1990). Also, scholars of international relations have a traditional interest in analyzing how political events and domestic decision making interact with international developments (Li and Thompson,

1975; Gourevitch, 1978; Huntington, 1991). Yet, due to their specific focuses, both research traditions had only limited impact beyond their sub-disciplines. Since a few years, however, the argument that decisions of countries or sub-national units are not independent from one another has motivated a vastly growing number of studies covering practically all sub-disciplines of political science. Widely noticed methodological and theoretical contributions from renown scholars have set the stage for this renewed interest in policy diffusion.

The critical juncture in the literature was that a collection of distinguished scholars shifted the focus from showing that policy adoptions follow spatial patterns to the analysis of “why” and “how” politicians make decisions interdependent from one another (Simmons, Dobbin and Garrett, 2006; Dobbin, Simmons and Garrett, 2007). The broad definition of diffusion, which Simmons, Dobbin and Garrett provide, is that “policy diffusion occurs when government policy decisions in a given country are systematically conditioned by prior policy choices made in other countries” (2006, 787). The core of that definition is to understand diffusion as a process of interdependent decision making, which can, but does not necessarily need to express itself in the spread of a specific policy (Gilardi, 2012). Accordingly, the term “interdependent policy making” captures more precisely the common process-oriented interest of scholars contributing to the recent turn in the literature than the term “diffusion,” which is directly linked to the more narrow outcome-oriented idea that a specific policy spreads.

In only a few years, a vast amount of empirical research has overwhelmingly supported the general argument that interdependence is a critical feature of policy making in various policy areas (Henisz, Zelner and Guillén, 2005; Shipan and Volden, 2006; Brooks, 2007; Linos, 2011). While the “if” question has been answered, the “why” and “how” of interdependence still pose substantial challenges. Conceptually, scholars tend to agree that the different dynamics of interdependent policy making can be classified into three broad classes of mechanisms: competition, learning, and emulation (Braun and Gilardi, 2006; Simmons, Dobbin and Garrett, 2006). This classification usefully defines common conceptual ground, but the mechanisms are very broad. Accordingly, students of interdependence need to theoretically elaborate on the specific dynamics of interdependence (Volden, Ting and Carpenter, 2008). A major challenge of the literature remains to theoretically unpack the underlying mechanisms of interdependent policy making.

Apart from defining common conceptual ground, methodological innovation was the other

critical element triggering the recent surge of research studying interdependence. Spatial analysis has become the standard method applied in the literature. Empirical models using that approach include as the main explanatory variable a so-called spatial lag, which is, formally expressed, the product of a row-standardized connectivity matrix, W , and the dependent variable, y . Simply put, a spatial lag is the weighted average of the dependent variable in other units, whereas the connectivity matrix, W , specifies the weights. Traditional spatial models have coded neighborhood as connectivities. In that case, the spatial lag for a specific unit is the sum of the dependent variable of its neighbors, divided by the number of neighbors. The estimates of the spatial lags reveal whether and, if so, the extent to which, policy makers react to policy changes in other units.¹ In the case of the neighborhood operationalization, the estimates show the responsiveness to neighbors' policy choices.

The key connection between the theoretical turn to the study of mechanisms and the methodological advances in spatial analysis revolves around the specification of the connectivity matrix, W , which has to be justified theoretically. Not long ago, scholars typically reported “evidence of diffusion and impute[d] that their favored mechanism is at work” (Dobbin, Simmons and Garrett, 2007, 463). The standard procedure was to model neighborhood as connectivities and to interpret the empirical results as evidence of learning, competition, or some other form of interdependence. Recent studies have gone beyond this rather crude approach by using various connectivities, such as traffic data, network measures, and economic indicators (Simmons and Elkins, 2004; Zhukov and Stewart, 2013; Cao and Prakash, 2012; Lloyd, Simmons and Stewart, 2012). Although scholars nowadays compute connectivities that are more convincing operationalization of the mechanisms they are interested in, there is still some concern that spatial models are based on over-simplified assumptions (Ward and Grundig, 2011).

In sum, theoretical and methodological advances have jump-started a vastly growing literature on interdependent policy making. However, despite substantial improvements, the main challenge, which is the theoretical and empirical unpacking of how and why policy makers are influenced by decision in other countries or subnational units, has not changed to date. Within that context of academic progress and unsolved puzzles, the main ambition of my research is to advance our knowledge of interdependent policy making. More specifically, in the research

¹Several methodological issues, from endogeneity concerns to the selection of the appropriate estimation techniques, complicate spatial analysis (Franzese and Hays, 2007, 2008; Ward and Gleditsch, 2008).

design, which I presented at the CIS PhD colloquium in spring 2009, I outlined two main ambitions. First, I intended to theoretically elaborate distinct arguments on interdependence that are relevant beyond the studied case. Second, based on the premise that interdependent decision making is not univocal, but can take different forms, I attempted to analyze multiple forms of interdependence within one policy area. To achieve these goals, I selected tax competition in Switzerland as the empirical setting. In the following, I discuss the rationale of that case selection.

2.2 Why Study Swiss Tax Competition?

Tax policy has been a popular area for diffusion scholars all along because the interdependent nature of tax policy making is straightforward (Hays, 2003; Basinger and Hallerberg, 2004; Swank, 2006). Although scholars have, quite understandably, focused on competition, more recent research has pointed to learning as a critical mechanism of interdependence. Jensen and Lindstädt (2012), for example, argue that corporate tax-cuts by left governments provide heuristic information about the success of such reform, which increases the likelihood that governments cut corporate tax rates. Baturo and Gray (2009) also develop a learning explanation, claiming that policy makers in central Europe introduced flat tax rates after they observed that this reform attracted foreign direct investment in other countries. The extension to learning shows that tax policy making, as a quintessential case of interdependence, is an interesting policy area for analyzing multiple forms of interdependent policy making beyond competition.

But why shift from the international to the sub-national level? One critical motivation was that the sub-national tax competition literature offers interesting analytical insights for elaborating on the mechanisms of interdependent policy making. Economists have a long record in the study of fiscal federalism. The theoretical debates of the literature are based on arguments, which have been part of abstract reflections ever since political philosophers, such as Rousseau or Montesquieu, pointed to the advantages of federal systems. Almost 50 years ago, Tiebout (1956) introduced the influential idea that an efficient allocation of public goods can be achieved when people are able to “vote with their feet” because policy makers in small and relatively homogenous jurisdictions are more responsive to the preferences of the electorate. Oates (1972, 2005) also argued that local public good provision is more efficient than centralized governance.²

²For a critical overview on the fiscal federalism contributions of economists, see Rodden (2006).

Challenging the welfare-enhancing Tiebout argument, several theoretical studies have argued that tax competition on the sub-national level is associated with a race-to-the-bottom in tax rates, causing under-provision of public goods (Zodrow and Mieszkowski, 1986; Wilson, 1986; Sinn, 2004). The asymmetric tax competition literature extends the work on the detrimental effects of tax competition by analyzing how small units react differently in tax competition than larger units (Wilson, 1991; Bucovetsky, 1991; Dehejia and Genschel, 1999). Further models identify spillovers as drives of interdependent decision making. Spillover models show that policy makers' tax and spending decisions are influenced by the extent to which they benefit from the public goods provision of nearby jurisdictions (Case, Rosen and Hines, 1993; Brueckner, 2003). Thus, the economics literature on sub-national tax competition points to various interesting theoretical aspects of competitive interdependence.

However, while the theoretical fiscal federalism literature is vast, empirical research lags far behind. Many theoretical predictions have not been empirically tested at all, and the studies that exist, typically test whether policy makers react to tax changes of their neighbors. Such research exists for the US states (Case, 1993; Deskins and Hill, 2010), local governments in the areas of Boston, Chicago or Belgium (Brueckner and Saavedra, 2001; Hendrick, Wu and Jacob, 2007; Heyndels and Vuchelen, 1998), Canadian provinces (Esteller-Moré and Solé-Ollé, 2002), French regions (Reulier and Rocaboy, 2009), or Swiss cantons (Feld and Reulier, 2009). The shortcoming of these empirical studies is that researchers impute, just like earlier diffusion scholars did, that the detected spatial interdependence, which they have tested with neighborhood connectivities, are a consequence of their favored theoretical model.

In sum, the complementary contributions of the diffusion and fiscal federalism literature, which set the stage for the first part of my dissertation, can be summarized as follows: while the vast formal work of the fiscal federalism literature offers analytical insights, which are useful to theoretically elaborate on the mechanisms of interdependent policy making, the advances of the diffusion literature, particularly the turn toward more accurate operationalizations of the mechanisms beyond neighborhood connectivities (Simmons and Elkins, 2004; Beck, Gleditsch and Beardsley, 2006), provide conceptual landmarks for improving the empirical investigation of tax competition dynamics.

But why Switzerland? I would argue that Switzerland, as one of the most fiscally de-

centralized countries in the world (OECD, 2011), provides a perfect empirical case to study sub-national tax interdependence, mainly because of specific features of the Swiss case. In Switzerland, cantonal tax autonomy has deep historical roots and is constitutionally protected (Gilardi, Kübler and Wasserfallen, 2013). Particularly income taxation is highly decentralized, and there is a large variation in income tax systems among the 26 cantons. The tax rate differences are substantial: in some cases, the tax due of high income earners drops to less than half after a change of residence. Moving to another canton is not only financially attractive, but due to the small size of the country also a feasible option.³ Within that setting, cantonal decision makers closely monitor the tax policies of other cantons, and the dynamics as well as the consequences of cantonal tax competition are recurrent topics in Swiss politics, which makes the Swiss case almost resemble a natural experiment for tax interdependence. Finally, various sources make it possible to collect exceptionally fine-grained data on the dependent variable (income tax rates) and the main explanatory variables (spatial lags).

The two Swiss studies of the dissertation illustrate that interdependence is not necessarily univocal, but can take different forms. While the first article shows that the quite intense tax competition for high income earners is driven by asymmetric competition, the second article argues that socialization effects in inter-cantonal networks attenuate tax competition dynamics. As will be discussed in more detail in sections 3 and 4, both analyses contribute theoretically and methodologically to the current challenges of the diffusion literature, which was the main ambition I intended to accomplish with my thesis.

2.3 Going Beyond the Swiss Case

An additional ambition of my dissertation was to use some of the insights of the Swiss analysis for studying relevant questions of international tax competition and cooperation. I already identified in the research design presented at the CIS PhD colloquium in spring 2009 the debates on tax harmonization in the EU as a potentially interesting case but, at that stage of the research, I deliberately left open which insights of the Swiss analysis should inform the investigation of European tax centralization. After I carried out the bulk of the Swiss research, I started my research stay at Harvard’s Weatherhead Center for International Affairs in September 2011, during which I worked on the EU tax centralization research. The year was dominated by

³Switzerland can be crossed in less than 4 hours.

the euro crisis, and the challenges of the EU were subject of many interesting roundtables and seminars at Harvard.

Inspired by that, I wrote an analysis on what I believe to be the defining feature of integration over the last decades—namely that economic and political integration have drifted apart with the creation of the single market and the monetary union. An important question within that broader context is why the heads of state could not agree on further political integration steps to complement the deep economic integration. A critical element of political integration is the construction of fiscal governance capacities, including the establishment of a European tax authority. In each intergovernmental conference since Maastricht, the heads of state discussed tax centralization proposals going in that direction. The EU article of this cumulative dissertation explains theoretically and empirically which member states were more likely to oppose such proposals and, thus, adds to our understanding of why political integration failed in an important area.

The objective to use insights from the Swiss study for research on EU tax centralization has been fulfilled in the sense that both analyses share the analytical argument of asymmetric payoff structures. The theoretical overlap is that I investigate asymmetric effects of tax competition dynamics in the Swiss case, and I use a similar framework to show that the europeanization of tax authority is associated with asymmetric costs and benefits for the member states. Specifically, the EU study argues that the cost-benefit variation of asymmetric tax competition in the single market explains the variation in support for European tax intervention. To some extent at least, the asymmetric competitive dynamic in the full-fledged federal system of Switzerland is comparable to the cleavage dividing the member states of the EU in the discussions on fiscal federal reforms. Tax competition dynamics in Switzerland and EU tax harmonization negotiations are dominated by asymmetric material interests.

3 Theoretical Contribution

Both Swiss analyses contribute to the diffusion literature by developing distinct arguments on the mechanisms of interdependence. The first article studies the context conditionality and asymmetric dimension of competition and the second, which I co-author with Fabrizio Gilardi, elaborates on the effects of socialization in intergovernmental organizations.

3.1 Article #1: Contextual Variation in Interdependent Policy Making

The most important theoretical contribution of the article on contextual variation in interdependent policy making to the diffusion literature is the focus on the context conditionality of interdependence (Cao and Prakash, 2012; Neumayer and Plümper, 2012). Standard diffusion studies assume that interdependence is uniform, which is often an unrealistic assumption, raising legitimate concerns that the dynamics specified in spatial models are over-simplified (Ward and Grundig, 2011). In any study on interdependent decision making, there are potential institutional, political, or geographic factors that might shape the extent to which policy makers are responsive to the choices made in other units. Accordingly, I argue that elaborating on the context conditionality of interdependent decision making is an effective strategy for a more accurate unpacking of the why and how of diffusion.

For the case of tax competition in Switzerland, the theoretical literature on asymmetric tax competition provides an account for cantonal heterogeneity in responsiveness. Most theoretical asymmetric tax competition models assume that size is the critical factor explaining variation in responsiveness (Bucovetsky, 1991; Wilson, 1991; Dehejia and Genschel, 1999). The basic argument of these models is that small units have smaller tax bases than larger units, which means that they need fewer additional taxable resources to compensate the revenue losses associated with tax cuts. Put differently, where mobile taxpayers reside is relatively more important for small units. The predictions of these models are as follows: the smaller a jurisdiction, the lower its tax level, and the more responsive will its government be to the tax changes of competitors.

The article on contextual variation of interdependence formulates a similar asymmetric tax competition hypothesis, based, however, on spillover arguments, which are the underlying driver in many theoretical tax competition models of the fiscal federalism literature (Wilson, 1999; Brueckner, 2003). One theoretical argument of spillover models is that units nearby centers with a comprehensive infrastructure benefit from positive externalities of the public good provision in the centers, and that the beneficial spillover from centers is important for attracting mobile tax payers. As a consequence, units benefiting from spillover are, like small units, in a relatively better position to attract mobile tax payers, which leads to similar predictions as the ones discussed before: the more a jurisdiction benefits from spillover, the lower its tax level, and the more responsive will its government be to the tax changes of competitors.

In sum, the argument put forward in this article provides a distinct theoretical account of interdependence using the analytical insights of tax competition models. The study takes advantage of the theoretical work of scholars interested in fiscal federalism for making a contribution to the current main ambition of the diffusion literature, which is to disentangle the mechanisms of interdependence. Of general relevance for the diffusion literature is furthermore the article's point of departure that the extent to which governments react to decisions of other units varies according to contextual factors. While in the article of this dissertation, the spillover argument explains variation in responsiveness, institutional, political, or geographic context conditionality is of relevance for other studies too. Generally speaking, the focus on heterogeneity is a promising strategy for disentangling the underlying mechanisms of interdependence.

3.2 Article #2: How Socialization Attenuates Tax Competition

The socialization article analyzes the effects of joint membership in intergovernmental conferences, arguing that, through socialization, personal interaction in regional conferences of finance ministers attenuates tax competition dynamics. The theoretical argument of this study builds on the international relations literature, which has shown that intergovernmental organizations are important venues for socialization. This literature follows the tradition of sociologists who have argued that decision makers are not only driven by rational motives, but that interaction among individuals in structured networks can result in common understandings and definitions of problems (Granovetter, 1985; Davis and Greve, 1997; Finnemore and Sikkink, 2001; Dobbin, Simmons and Garrett, 2007).

Several studies covering various policy areas have shown that countries joining the same intergovernmental networks converge on interests and adopt similar policies (Bearce and Bondanella, 2007; Bach and Newman, 2010; Greenhill, 2010; Cao, 2009, 2010). However, it is difficult to distinguish whether these correlations are the result of socialization in networks or rather an artifact of self-selection into the networks. The advantage of our research is that the participation in the regional intergovernmental conferences is exogenous to tax competition interests because the compositions of the regional conferences have historical origins, are geographically motivated, and are constant across policy areas. This research design advantage, however, does not solve the general challenge of elaborating a clear understanding of how

socialization in networks translates into policy making.

Our definition of socialization is based on the argument that discussions in intergovernmental organizations create specific norms, which are expectations about appropriate behavior, and that social interaction within the intergovernmental organizations potentially induce norm-conforming behavior (Coleman, 1990; Young, 1996; Johnston, 2001; Checkel, 2005). With qualitative research, we analyzed the discussions and internal dynamics in inter-cantonal conferences. Several interviews with officials revealed that tax competition is a recurrent topic in regional conferences, and that some annoyance with aggressive tax practices is internally but not publicly expressed. On the basis of qualitative insights and the theoretical literature on norm creation and norm-conforming behavior, we hypothesize that the regular and intense exchange in the inter-cantonal conferences, in which also discussions on the appropriate level of competition are held, limits the extent of competitive interaction among the cantons joining the same regional conferences. It is important to note that we do not argue that socialization in inter-cantonal conferences would prevent competition altogether, but that it constrains the intensity of competition.

A contribution of our analysis to the socialization literature is that we study the argument that joint membership in intergovernmental organizations alters policy decisions in a policy area where significant financial interests are at stake, which is a harder test than the study of ideational policies, such as human rights (Finnemore and Sikkink, 2001; Greenhill, 2010). Finally, I would like to stress that this article goes explicitly beyond competition by showing that tax interdependence is not univocal, but that it can take multiple forms.

4 Methodological Contribution

The Swiss analyses use travel data and commuting patterns to model competitive tax interaction among cantons. I argue that these fine-grained connectivity measures accurately approximate the underlying micro-mechanism driving tax competition—namely that policy makers are responsive to the tax decisions of cantons, to which high-income earners might move if the tax rates become relatively more attractive there. Apart from the nuanced operationalization of competitive tax interaction, I introduce in both articles on Swiss tax competition methodological innovations that are relevant for the diffusion literature. The empirical strategy put

forward in the socialization article allows researchers to investigate whether policy makers react more or less strongly to different configurations of other units, and the model specification in the contextual variation study is designed for the empirical analysis of contextual variation in responsiveness.

In the socialization article, we combine multiple connectivity data for evaluating how two mechanisms (socialization and competition) interact with one another. Concretely, we hypothesize that finance ministers react more strongly to tax changes of competitors, which are organized in other regional conferences, as compared to the competitors with which finance ministers extensively interact. To test that hypothesis, we create on the basis of the competition measure two additional connectivity matrices, which contrast competitors that belong to the same regional conference with those that do not. This comparative procedure combines multiple connectivities and tests whether joint participation in the same regional conferences alters competitive interaction among cantons. The developed empirical strategy analyzes, by construction, multiple forms of interdependence and provides some guidance for researchers who want to investigate whether policy makers react differently to specific configurations of other units.

The contextual variation article, in contrast, proposes an innovative empirical strategy for the case that students of interdependence theorize that specific units are more responsive than others because of structural factors. The motivating argument here is not that units react more or less strongly to different configurations of other units, but that the policy makers of specific units are more responsive to policy decisions made in other units. Conceptually, the empirical strategy put forward challenges the conventional approach of most diffusion studies, which assume that interdependence is uniform among the units of analysis. A handful of recent articles has analyzed heterogeneity in responsiveness (Basinger and Hallerberg, 2004; Cao and Prakash, 2012). The standard method applied in these studies is to interact the spatial lag with a variable that is supposed to mediate interdependent policy making. The time-series cross-section models include unit fixed effects. Researchers using this modeling strategy are restricted to the analysis of variation over time, given that the fixed effects absorb level-heterogeneity across units. Accordingly, this specification is reasonable when researchers argue theoretically that change over time in a specific variable conditions the extent to which governments are

responsive to decisions in other units.

I would argue, though, that in many cases *contextual* factors mediate the extent to which policy makers' react to decisions made in other units. Typical contextual variables that influence the responsiveness of policy makers are structural determinants, such as institutional, political, and geographic variables. In the case of mediation through structural variables, the analysis of contextual variation (across the units) has to be combined with the analysis of dynamic interdependence (modeled with spatial lags). We thus need a specification that models both time-invariant contextual variation and dynamic interdependence, which is not possible with the standard time-series cross-section approach including fixed effects. As alternative, I introduce in the contextual variation article hierarchical time-series cross-section models, which allow the testing of context conditional interdependence (Western, 1998; Zorn, 2001; Bartels, 2011).

The generic linear multilevel regression model I propose consists of two levels, whereas the spatial lag, as a dynamic variable, is modeled on Level-1 and the contextual factor on Level-2. The multilevel setup is then extended to allow the estimates of the spatial lag to vary across units as a function of the contextual variable. Accordingly, the estimates of the varying spatial lag slope show whether policy makers' responsiveness is contingent on the contextual variable. In the article of this dissertation, the positive externalities from centers are the contextual factor mediating competitive interaction, following the hypothesis that cantons situated close to big centers have a structural comparative advantage in tax competition because they benefit from spillover. Yet the same modeling approach can be used to investigate any contextual conditionality of interdependence that is based on structural institutional, political, or geographic arguments.

5 Findings and Implications of the Swiss Analysis

Apart from the theoretical and methodological contributions, the normative and policy implications of the thesis' findings deserve some attention too. Consistent with previous research (Feld and Kirchgässner, 2001; Feld and Reulier, 2009), the empirical findings of my dissertation corroborate that competition is the critical element of cantonal tax decision making. Going beyond that empirical observation, the two Swiss articles provide a nuanced analysis of the drivers and constraints of inter-cantonal tax competition dynamics. The results of the con-

textual variation study show that cantons benefiting from spillover of nearby centers tax high income earners at substantially lower levels, and that they react more strongly to tax decisions of competitors. The latter finding essentially suggests that cantons with a comparative advantage in tax competition accelerate competitive dynamics. In other words, cantons initiate and reinforce interdependence, depending on how much they benefit from the public good provision of nearby centers.

While the article on contextual variation focuses on asymmetric dynamics, the socialization study adds to the literature on institutional and political constraints of tax competition. Recent political science research has documented that the role of veto players, electoral and labor market institutions, fiscal constraints, and equity norms limit downward pressures on tax rates (Hays, 2003; Basinger and Hallerberg, 2004; Plümper, Troeger and Winner, 2009). Our findings indicate that norm creation and enforcement in intergovernmental organizations also limit tax competition. The empirical results of the socialization article show that cantons compete less strongly if finance ministers interact in regional conferences because participation and exchange in intergovernmental organizations attenuate tax competition dynamics.

5.1 Policy Implications

The main institutional instrument in Switzerland for regulating inter-cantonal tax competition is a sophisticated fiscal equalization system, which has recently been completely changed as part of a broad federal reform. The federal reform was implemented in 2008, and because of its comprehensiveness is also called “the reform of the century” (Braun, 2009). The fiscal equalization system adjusts, through substantial inter-cantonal transfer payments, tax and fiscal disparities. Essentially, the cantons that can levy large tax revenues from corporations and high income earners support, according to a pre-specified estimation procedure, recipient cantons with less favorable socio-economic structures (Dafflon, 2004). In the Swiss case, the most effective political instrument for accelerating or alleviating inter-cantonal tax competition is to increase or decrease the overall amount of equalization payments, which is technically straightforwardly implemented but, of course, depends on the power balance in the political arena.

Another important part of the vast federal reform is the emphasis on inter-cantonal and regional collaboration. New measures, including a federal enforcement mechanism, have been

introduced for promoting inter-cantonal cooperation and agreements, which should, among others, regulate the shared financing of public goods with regional importance. This aspect of the reform is supposed to limit free-riding by addressing the problem that cantons benefit from services of centers without paying for them. However, criticism and concerns dominated the discussion about federal enforcement mechanisms. It was argued that any sort of federal enforcement would interfere with cantonal sovereignty, and that inter-cantonal arrangements of public goods provision were lacking sufficient democratic legitimacy (Steinlin, 2011). Given the strong resistance, it comes as no surprise that the eventual enforcement mechanisms are weak. Recent examples in health care, education, and culture suggest that the new instruments fall short in satisfying the (already low) expectations (Füglister and Wasserfallen, 2014).

Taking position against the voices criticizing measures promoting inter-cantonal cooperation, the results of my thesis strongly support the introduction of effective mechanisms that facilitate inter-cantonal cooperation. The findings of the contextual variation article provide strong analytical and empirical grounds for inter-cantonal arrangements regulating the joint financing of public goods provision with regional impact; and the socialization study shows that the interaction and exchange of information among cantonal policy makers affects policy making. Accordingly, I recommend, based on the dissertation's findings, to revise this part of the federal reform and to design a framework that further stimulates inter-cantonal and regional collaboration. An effective revised framework should include stronger federal enforcement powers and the use of federal financial incentives.

5.2 Normative Implications

Apart from the policy implications, the detailed analysis of interdependence in cantonal decision making points to important normative questions of the diffusion literature. As outlined before, diffusion researchers think about why and how policy makers react to the decisions made in other units. The theorizing of that question is then followed by an empirical test of interdependence. What is typically missing in diffusion studies, however, (and the articles of this thesis are not necessarily exceptions in that regard), is a normative discussion of the analyzed interdependent policy making, and the empirical testing of the assumptions driving interdependence.

A full-fledged analysis of interdependent policy making, including the investigation of as-

sumptions, requires a substantial collective research effort. The vast research on Swiss tax competition is at a point where we have a quite comprehensive understanding of interdependence, allowing to reflect on normative questions. Let us start with the core assumption of tax competition models, that the taxable income for which policy makers compete is at least partially mobile. It is uncontroversial to argue that Swiss policy makers take that assumption for granted, as they expect high income earners to change residence because of cantonal tax reforms. Accordingly, the challenge for students of interdependence is to model which cantons are, in the view of policy makers, the relevant competitors. All that matters is the perception of policy makers, given that models of interdependence eventually seek to explain policy making. I have argued that my thesis provides accurate solutions in that regard. However, what remains an open question is the extent to which the perception of policy makers is actually based on empirical evidence. This question is critical because the answer to it tells us whether tax competition is driven by the mobility of tax sources, or whether interdependence is rather politically constructed.

On the international level, tax competition studies assume that corporate tax levels are important for attracting business activity (Devereux, Lockwood and Redoano, 2008). Some studies provide empirical evidence for the mobility assumption (Hines, 1999), but more recent research finds no correlation between corporate tax rates and flows of foreign direct investment (Jensen, 2012). In the Swiss case, economists argue, based on the observation that the share of high income earners is greater in cantons with lower tax rates, that citizens choose their place of residence depending on tax rates (Kirchgässner and Pommerehne, 1996; Feld and Kirchgässner, 2001).⁴ However, the causal interpretation of that correlation is problematic because of the endogeneity problem that lower tax rates for high income earners can be both the cause and effect of high shares of wealthy residents (Schmidheiny, 2005). Brülhart and Parchet (2014) provide the most comprehensive analysis of the mobility assumption for the Swiss case by investigating whether wealthy elderly individuals change residence as a reaction to cantonal bequest tax reforms. They find that tax competition was the most prominent argument in legislative debates for the reduction of bequest tax rates, but wealthy elderly individuals did not systematically change residence because of such reforms. Consequently, they conclude that inter-cantonal tax competition is “alleged” not “real.”

⁴More recent studies find no evidence for tax-induced migration (Liebig and Sousa-Poza, 2006).

The reported results suggest that Swiss tax competition is largely based on the constructed perception of policy makers, not necessarily on real pressures stemming from tax base mobility. The socialization article, which shows that joint membership in regional conferences mitigate tax competition dynamics, supports the view that interdependence is shaped by the political discourse and institutions. Thus, while competition is an important component of an ideologically loaded debate, the extent to which cantons actually are pressured by tax cuts of competitors is unclear and rarely debated. Now, if interdependence dominates policy making, as it is the case in Switzerland, because politicians take the drivers of interdependence for granted, instead of reflecting on their empirical validity, the normative judgement of interdependent policy making is not positive. Such a critical normative assessment of interdependence contrasts with the positive view of the American federalism literature, which argues that federal systems are superior because sub-national units serve as policy laboratories, inventing new policies and promoting best practices. Whether interdependence is good or bad depends on the specific processes.

6 Findings and Implications of the EU Analysis

The findings of the EU study contribute to the debate on the defining normative question of whether European integration should be foremost a political or an economic project. This question overshadows discussions on the nature, shortcomings, and challenges of the EU. For example, the conflicting perspectives in the academic literature on the democratic deficit reflect profound disagreement about this fundamental question of integration. While Follesdal and Hix (2006, 534) identify democratic legitimacy as a flaw of the current institutional framework because “a democratic polity requires contestation for political leadership and argument over the direction of the policy agenda[,]” which is, by and large, absent in the case of the EU; Majone (1998) and Moravcsik (2002) take the opposite view, arguing that such democratic standards would not apply to the EU because its mandate is restricted to technical and economic functions of low electoral salience.

The EU tax centralization article reflects on specific aspects of this general debate by showing that economic integration and political integration have drifted apart over the last two decades. This study argues that the successful economic integration of the single market and the monetary union increasingly constrain the national room to maneuver in taxation, a core state function

of high electoral salience, which is in line with the contributions of Genschel and Jachtenfuchs (2013) and Scharpf (1994, 2009, 2011). The basic problem is that the deep economic integration is undermining national taxing powers and the national control over public revenue, while, at the same time, the heads of state are reluctant to transfer political authorities to the EU to compensate for the contraction of member states' governance capacities. The most recent example of that general dilemma is that national governments of the eurozone members have lost, after delegating monetary policy to the supranational level, macroeconomic options, which have not (yet) been compensated with European economic and fiscal competences.

The broader point is that Majone (1996) and Moravcsik (1998) are right in emphasizing that the EU does not have a mandate in politically salient issue areas, such as redistribution and taxation; however, the lack of such European authorities does not mean that national legislators and governments could keep national autonomy and sovereignty in those areas. In fact, the deep economic integration imposes substantial constraints on the room to maneuver of democratically accountable national governments. Based on that insight, I argue that the model of deep economic integration without political integration on the European level does not represent a "logical endpoint" of integration (Moravcsik, 2001, 163)—if anything, it is an unsustainable institutional framework. To contribute to that broader debate, the EU article of my dissertation analyzes why the heads of state could not agree on political integration steps for compensating the contraction of national governance capacities. I investigate that general question for the case of tax centralization.

Using a political economy framework on the costs and benefits of tax centralization for member states, the analysis of the Maastricht, Nice, and Lisbon intergovernmental conferences suggests that basic cost-benefit calculations were the critical drivers of tax centralization politics. Specifically, the empirical findings show that low-tax countries were more likely to oppose European tax intervention, and that the increased tax heterogeneity after the accession of the central and eastern European countries made tax centralization among the EU-27 even more unlikely than it was before the enlargements. The EU article, thus, explains analytically and empirically why further shifts of tax authority to the European level failed, and it discusses the implications of the monetary union and the enlargements for the politics of tax centralization.

The general lesson of the EU analysis is that the benefits of centralizing political authority

outweigh the costs only if there is some degree of homogeneity among the countries that pool authority. While the accession of the central and eastern European countries has led to increased heterogeneity among the EU-27, the introduction of the euro resulted in the creation of a deeply integrated core group of member states, which increasingly divides the eurozone from the non-eurozone countries. The findings of the analysis suggest that it becomes more and more attractive for the eurozone countries to pool fiscal, tax, and economic competences among themselves. The centralization of such authorities within the eurozone area is also politically more feasible, given that the heterogeneity among the eurozone countries is significantly lower (compared to the heterogeneity among the EU-27). The policy recommendation of the EU article, thus, is to build political institutions and decision making mechanisms for the members of the monetary union and to concentrate the pooling of tax and economic political authorities to the eurozone area.

7 Conclusion

This synopsis discussed the ambition, findings, methodological and theoretical contributions, as well as the policy and normative implications of my cumulative dissertation. The two Swiss articles of the thesis analyze a quintessential case of interdependent policy making by studying tax competition among Swiss cantons, and the third article investigates the politics of EU tax centralization.

The main ambition of my thesis, accomplished with the two Swiss articles, was to contribute to the vastly growing literature on interdependent policy making. The first Swiss study shows that cantons benefiting from the spillover of nearby centers react more strongly to the tax decisions of competitors. The article argues that the study of contextual conditionality is a promising strategy for disentangling the mechanisms of diffusion. The second Swiss article hypothesizes that norm creation and norm-conforming behavior, induced by socialization in intergovernmental organizations, affect competitive dynamics. The analysis contributes to the diffusion literature by exploring in-depth the socialization mechanism. Apart from the theoretical contributions, the normative assessment of the research on Swiss tax competition contrasts with the positive view of the American federalism literature, which argues that policy makers in sub-national units rationally monitor policies in other states and introduce them,

if they have been successful elsewhere. In the case of Swiss tax competition, interdependent decision making is largely driven by the constructed perceptions of policy makers, not a rational welfare-maximizing updating process.

The third study of the cumulative thesis investigates the negotiations of EU tax centralization proposals in intergovernmental conferences. Similar to the Swiss tax competition research, the theoretical framework of the analysis is based on asymmetric payoff structures. The most important contribution of this study is its relevance for the current discussion on the institutional challenges of the EU. The article argues that the deep economic integration increasingly constrains fiscal and tax policy making at the national level, and that the member states could not agree on political integration steps for compensating this contraction of national governance capacities. The findings of the analysis suggest that the monetary union made the pooling of fiscal and tax authority among the members of the eurozone more beneficial and, thus, recommends to focus on political integration within the eurozone area.

In sum, two articles of my cumulative dissertation contribute theoretically and methodologically to the diffusion literature, the findings of the Swiss analyses add to the political tax competition debate in Switzerland, and the EU article provides insights for the discussions on the institutional challenges of European integration.

Part II

Bibliographical Information on the Published Articles

1 Article #1: Contextual Variation in Interdependent Policy Making: The Case of Tax Competition

Wasserfallen, Fabio (2014), "Contextual Variation in Interdependent Policy Making: The Case of Tax Competition", *European Journal of Political Research*, early view.

DOI: 10.1111/1475-6765.12058

Link: <http://onlinelibrary.wiley.com/doi/10.1111/1475-6765.12058/abstract>

2 Article #2: How Socialization Attenuates Tax Competition

Gilardi, Fabrizio and Fabio Wasserfallen (2014), “How Socialization Attenuates Tax Competition”, *British Journal of Political Science*, early view.

DOI: <http://dx.doi.org/10.1017/S0007123414000246>

Link: <http://journals.cambridge.org/action/displayAbstract?fromPage=online&aid=9304472&fulltextType=RA&fileId=S0007123414000246>

3 Article #3: Political and Economic Integration in the EU: The Case of Failed Tax Harmonization

Wasserfallen, Fabio (2014), “Political and Economic Integration in the EU: The Case of Failed Tax Harmonization”, *Journal of Common Market Studies* 52(2), 420-435.

DOI: 10.1111/jcms.12099

Link: <http://onlinelibrary.wiley.com/doi/10.1111/jcms.12099/abstract>

Part III

Curriculum Vitae:

Fabio Wasserfallen, 17.02.1983.

1 Academic Positions

Assistant Professor of Political Economy (with tenure track), Salzburg Centre of European Union Studies, University of Salzburg, since spring 2014.

Associate Research Scholar, Princeton Institute for International and Regional Studies, Fung Global Fellows Program, Princeton University, academic year 2014-2015.

Research and Teaching Fellow, Department of Political Science and Centre for Comparative and International Studies, University of Zurich, since fall 2008.

2 Education

Ph.D. student, Department of Political Science, University of Zurich, 2008-2013.

Visiting graduate student, Weatherhead Center for International Affairs, Harvard University, Program on Transatlantic Relations, academic year 2011-2012.

Lic.rer.soc. (Master of Arts), summa cum laude, University of Bern, Major: Political Science, Minors: Law and Economics, 2002-2008.

Visiting student, Department of Political Science, University of Aarhus, spring term 2007.

3 Journal Articles (peer-review)

Fabio Wasserfallen (2014), “Contextual Variation in Interdependent Policy Making: The Case of Tax Competition”, *European Journal of Political Research*, early view.

Gilardi, Fabrizio and Fabio Wasserfallen (2014), “How Socialization Attenuates Tax Competition”, *British Journal of Political Science*, early view.

Füglister, Katharina and Fabio Wasserfallen (2014), “Revitalizing Swiss Federalism in a Changing Environment”, *Comparative European Politics*, 12(4/5), 404-421.

Fabio Wasserfallen (2014), “Political and Economic Integration in the EU: The Case of Failed Tax Harmonization”, *Journal of Common Market Studies*, 52(2), 420-435.

Fabio Wasserfallen (2010), “The Judiciary as Legislator? How the European Court of Justice shapes Policy-Making in the European Union”, *Journal of European Public Policy*, 17(8), 1128-1146.

4 Book Chapters

Bochsler, Daniel and Fabio Wasserfallen (2013), “Multilevel elections and second order effects in Switzerland”, in Dandoy, Regis and Arjan H. Schakel (eds), *Regional and National Elections in Western Europe*, Basingstoke/Houndmills: Palgrave Macmillan.

Gilardi, Fabrizio / Kübler, Daniel and Fabio Wasserfallen (2013), “Cantonal tax autonomy in Switzerland”, in Ruiz-Almendral, Violeta and François Vaillancourt (eds), *Tax autonomy of subnational entities*, London: McGill-Queen’s University Press.

5 Teaching

Policy diffusion research seminar (graduate level), co-instructor with Prof. Fabrizio Gilardi, University of Zurich, academic years 2009-2010, 2010-2011, 2012-2013, and 2013-2014.

Applied data analysis (graduate level), co-instructor with Lucas Leemann, University of Zurich, spring term 2013.

Comparative political economy of taxation (undergraduate level), University of Zurich, fall term 2012.

6 Award, Fellowships and Research Grant

Fung Global Fellowship, Princeton Institute for International and Regional Studies, Princeton University, (\approx USD 100,000), 2014-2015.

Grant by the Swiss National Science Foundation for the project “Direct democracy, popular majorities, and policy choices”, (CHF 34,498), co-principal investigator with Fabrizio Gilardi

and Lucas Leemann, 2012-2013.

Fellowship for prospective researchers, Swiss National Science Foundation, (USD 57,000), 2011-2012.

Award from the Faculty of Business, Economics, and Social Sciences, University of Bern, for high grades (summa cum laude), (CHF 1,000), 2008.

7 Conference Paper Presentations

Meeting of the American Political Science Association (APSA)	2010, 2009
International Conference of Europeanists (CES)	2013
ECPR General Conference	2009
Conference of the European Political Science Association (EPSA)	2014, 2013, 2011
Convention of the International Studies Association (ISA)	2012, 2011
MPSA Annual Conference	2013, 2010
Congress of the Swiss Political Science Association (SVPW)	2014, 2013, 2010, 2009
Association for Contemporary European Studies (UACES)	2012

8 Media (excerpt)

Interview with Norwegian TV on Swiss Politics, February 16, 2014.

Article on my dissertation in magazin (University of Zurich), 22(2), Mai 2013, p. 22-23.

Blog contribution on Swiss tax competition to the European Politics and Policy blog of the London School of Economics and Political Science (with Fabrizio Gilardi, September 5, 2012).

Article in Berner Zeitung, “Der verzerrte Steuerwettbewerb”, (November 11, 2010, p. 2).

Interview with Le Temps on the Social Democrats, April 7, 2010.

Article in Das Magazin on the Left in Switzerland, No. 2010/12.

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